

SEP 6 1979

MICHAEL RODAK, JR., CLERK

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1979

No. 79-120

THOMAS S. CARPENTER, ELLIOTT TAYLOR,
ELDO GROGAN, WILLIAM MILLS, and
GENE PATTON,

Petitioners,

v.

EDWARDS AND WARREN, PROFESSIONAL ASSOCIATION;
MARK B. EDWARDS; JOSEPH WARREN, III; GRESHAM
NORTHCOTT; BETEX CORPORATION, a North Carolina
corporation; HARRIS, UPHAM & COMPANY, INC.;
MICHAEL B. ALLRAN; EDWARD R. ANDERSON; A. J.
BEALL, JR.; ANNE C. HAWLEY; BARBARA MORGAN;
ROBERT S. MORGAN; G. F. PARKER; SAMUEL WHITE;
R. W. CANNON; DOMINIC CAPELLI; PAULINE CAPELLI;
FRANK W. CAYCE; JOHN GAYLORD, JR.; JOHN A.
JENKS; and FRANK MANSHIP,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE
FOURTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Was Harris Upham and Company, Inc. a controlling person, under §15 of the Securities Act of 1933 [77 U.S.C. 77(o)], of its former employee, Gresham Northcott, at the time Northcott participated in the sale of unregistered securities to Petitioners?

STATEMENT OF THE CASE

The following additional facts do not appear in Petitioners' statement of case:

1. Of the five petitioners, only Carpenter has ever been a customer of Harris Upham. The remaining four had no contact at any time for any reason with Harris Upham. Taylor was introduced to Northcott through Carpenter. Carpenter was an experienced trader in securities and commodities. He was sophisticated in common stocks, had invested in oil and gas, had sold short, had sold short against the box, had bought and sold options and was familiar with straddles, puts and calls. He has maintained margin accounts at Harris Upham, Reynolds Securities and Merrill Lynch (losing \$49,000 of a \$50,000 investment in the latter account). Carpenter's contracts

upon which suit was filed are dated May and September, 1974. There is no evidence that Harris Upham knew of Carpenter's contracts. Taylor's contract is also dated September, 1974. Taylor, Grogan, Mills and Patton all concede that Harris Upham did not know they had any transactions with Northcott. Grogan sued on contracts entered in June and July of 1974. Mills and Patton signed their contracts in July of 1974 and their sole source of information concerning the contracts was their co-petitioner Grogan. Mills and Patton never even talked to Northcott before signing their contracts.

2. With respect to all contracts at issue on this petition, Harris Upham received no compensation of any kind on any transaction; no employee of Harris Upham knew prior to or at the time of the transaction of any of Petitioners' signing the contracts; no petitioner lost any money prior to Northcott's termination at Harris Upham; no petitioner thought they were dealing with Harris Upham regarding the contracts sued upon; the Petitioners were aware of the inherent risk in these invest-

ments which returned large profits (60%) in a very short time, three to six months; no petitioner ever delivered money to Harris Upham or received any transaction confirmation from Harris Upham regarding the contracts; no petitioner made any complaint to Harris Upham, until these lawsuits were filed; Harris Upham had absolutely nothing to do with any of Petitioners' contracts.

3. The present Petition has distilled Petitioners' earlier claims to the sole question of whether or not Harris Upham was a controlling person of their former employee three months, five months and seven months following his departure from the brokerage firm.

REASONS WHY THE WRIT SHOULD BE DENIED

The summary judgment procedure authorized by Rule 56 is a method for promptly disposing of actions in which there is no genuine issue as to any material fact or in which only a question of law is involved. 10 Wright & Miller, Fed. Prac. & Proc., Civil, §2712, p. 370 (1973), [numerous

cases cited.]

A review of the petition seeking a writ of certiorari in this case points to the obvious conclusion that Petitioners do not seriously contend factual issues abound which prevent entry of summary judgment. Rather, they argue that both the District Court and the United States Court of Appeals for the Fourth Circuit have misunderstood this Court's holding in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) and the statutory meaning of the word "control" as used in §15 of the Securities Act of 1933, 15 U.S.C. §77(o).

Petitioners point to no factual controversy to support the argument that material facts are in dispute. Both the District Court and the Court of Appeals examined better than 5,000 pages of pre-trial discovery, exhibits approaching 1,000 in number and a plethora of briefs from parties to the litigation.

The District Court simply held that it knew of no theory which supported a judgment against Harris Upham based upon the actions taken by Gresham Northcott after he left the employ of Harris Upham.

The argument that Harris Upham could have made a report to the New York Stock Exchange which might have resulted in the Exchange calling Northcott before the S.E.C. which could have stopped Northcott before he injured Plaintiffs was described by Judge McMillan as "tenuous." He found that Harris Upham was not a "controlling person" as that term was used in the relevant portions of the 1933 Act. [District Court Order, Court of Appeals Appendix, page 737]

The Court of Appeals in affirming summary judgment stated "...Harris Upham could not have been liable as a controlling person under the facts of this case." 594 F.2d 388, 391 (1979). Following a petition for rehearing filed by these same Petitioners, neither the panel nor any judge of the Court thought further hearing would benefit that court or change the result. [Appendix to this Brief in Opposition]

Petitioners seek to impose liability upon a brokerage firm for the acts of its former employee, which acts took place three, five and seven months following the former employee's termination from the

firm. What the broker did before he left the firm, what Harris Upham did while he was with the firm, at his departure, and following his departure was not seriously contested by any of the parties. It is the legal question which stimulates the present Petition, i.e., do the facts support the imposition of "control" liability on this brokerage firm for conduct, actually unknown to the brokerage firm, which occurred after he was no longer employed by Harris Upham?

Respondent suggests that if Harris Upham had no "actual control" it is not liable. In the legislative history of the control sections, Congress explicitly stated that control was to be actual, as well as legally enforceable. See Burden of Control, 6 S.E.C. Law Review, 616 at 620 (1974). A quote from Ferland v. Orange Groves of Florida, Inc., 377 F. Supp. 690 (M.D.Fla., 1974) is illustrative. There, the Court speaking of the control section of both 1933 and 1934 Acts held:

"...for purposes of attaching liability under either provision in a manner consistent with due process, the person sought to be held liable for the conduct of

another must be shown to have had the lawful authority to control or influence the conduct in such a way as to have been able to avoid liability. Strong v. France, 474 F.2d 747 (9th Cir., 1973)."

See also Jackson v. Bache and Co., Inc., 381 F. Supp. 71 (N.D.Cal., 1974).

In Sennott v. Rodman & Renshaw, 474 F.2d 32 (8th Cir.), cert. den. 414 U.S. 926 (1973), in construing the control section under the 1934 Act, the Eighth Circuit noted that the brokerage firm's duty to control its partners, agents as well as past employees extended only to transactions with or by these parties where the brokerage firm was itself involved. To extend it further "...would be to impose liability upon Rodman for virtually any act of its past or present employees or partners, regardless of how remote and unrelated that act might be to Rodman..."

The Securities and Exchange Commission defines control as follows:

"The term 'control'...means the possession directly or indirectly of the power to direct or cause the direction of management and policies of a person, whether through the

ownership of voting securities, by contract or otherwise. 17 C.F.R., §231.405(f) (1971)."

Petitioners do not point to a single authority where the "control" section of either the 1933 or 1934 Act has been extended to cover a situation in which a brokerage firm obtains liability for the acts of its former employees (or person otherwise associated with the firm) following termination of his employment or association with the firm. [Reading the opinions in Hawkins v. Merrill Lynch, 85 F. Supp. 104 (W.D.Ark., 1949), and Rochez Brothers, Inc. v. Rhoades, 527 F.2d 880 (3rd Cir., 1975) makes clear that Petitioners' reliance on these cases is misplaced.]

Respondent does not contend that "control" is exclusively an employer-employee or respondeat-superior relationship. On the other hand, a consistent theme is revealed in prior cases dealing with the subject and in each instance, found by Respondent, where liability was imposed, the control of the brokerage firm or principal continued through the illegal act. Where there is a break or interruption in the

direction of the alleged controlling party over the miscreant, no control has been found. That is exactly the posture of the instant case. Northcott was terminated on February 1, 1974 and Harris Upham had absolutely nothing to do with him or anybody he dealt with after that date. The firm had no "control" over him or what he did after February 1, 1974 any more than his parents, school teachers or ministers when he left those respective superiors.

Petitioners argue that had Harris Upham filed a "bad report" with the New York Stock Exchange following Northcott's termination, then Petitioners, if 14 or 15 other events had occurred, would not have entered into any contracts with Northcott in May, July and September, 1974. The speculative and conjectural nature of this argument would seem apparent on its face. It is also true that if Northcott had been run over by a truck the day after he left Harris Upham, Petitioners might not have entered into contracts with him. The District Court described the "chain" as "tenuous." The Court of Appeals agreed. 594 F.2d 388, 395. As the Court of Appeals

observed, the fact that Harris Upham knew that Northcott was referring customers to McKinney in 1973 and a more thorough investigation, beyond their telling Northcott to stop such referrals, might have revealed more, does not impose control liability once Northcott is no longer with them.

It is perhaps charitable, at best, to recognize that the "RE-4" argument is a bootstrap attempt to impose liability under an implied cause of action against Harris Upham for purportedly violating the New York Stock Exchange Rules. This Court's recent opinions in Cort v. Ash, 422 U.S. 66 (1975) and Piper v. Chris-Craft Industries, Inc., 430 U.S. 1, reh. den. 430 U.S. 976 (1977) and the lengthy opinion of Judge Friendly in Colonial Realty Corp. v. Bache and Co., 358 F.2d 178 (2nd Cir.) cert. den. 385 U.S. 817 (1966) compel the conclusion that no implied cause of action exists in this instance, even if the Court found that Harris Upham had breached a New York Stock Exchange rule. The nature of the reporting rule makes clear it was not designed for the general public but rather was designed for the benefit of members of the Exchange,

there is no specific jurisdictional grant in any statute to imply such a cause of action, the legislative intent was to professionalize the brokerage business and encourage ethical self-regulation and it is not necessary to imply a cause of action because there are state common law remedies.

Respondent further suggests that "what would have or might have" happened is basically immaterial. The cases on control demonstrate that there is no controlling person liability where the alleged controlling person receives no direct benefit from the illegal transaction, had no directional relationship with the wrongdoer at the time of the wrong, and does not even know of the particular transaction giving rise to liability. Harris Upham falls into that category and should not be subject to suit as the "deep pocket" or an insurer for Petitioners' losses.

Beyond the events surrounding Northcott's termination in January, 1974, effective February 1 of that year, Defendants offered no evidence of any conduct on the part of Harris Upham related to their individual purchase of cattle contracts through Northcott. It is almost incon-

ceivable to suggest that Harris Upham could somehow have knowledge or reasonable ground to believe in the existence of facts by reason of which the liability of Northcott was alleged to exist. That "due care" standard affords Harris Upham a complete defense even if it were a "controlling" person of Northcott. On the same record upon which the Court of Appeals found no control, they similarly found no factual controversy that Northcott had not been adequately supervised while with the firm and certainly he was not subject to supervision when he left the firm.

Whether the Court of Appeals for the Fourth Circuit has misinterpreted the language used by this Court in Hochfelder in distinguishing between theories of liability under the 1933 and 1934 Acts is not pertinent to the result in this case. Respondent concedes that there is support for the proposition that negligent conduct is a basis for liability under 15 U.S.C. §77(o), the control provisions subject of this appeal, based upon the express language in Hochfelder. It appears to Respondent that the reference to the controlling person

provision where the Fourth Circuit makes its statement regarding a state of mind condition requiring "a showing of something more than negligence to establish liability" was specifically directed to liability under the 1934 Act, which under the ruling in Hochfelder would require a showing of scienter, something Petitioners utterly failed to prove throughout this particular litigation. From the earlier paragraph on page 394 of the Fourth Circuit's Opinion, it is clear that they correctly observed that this Court has noted in each instance where Congress has created express civil liability, it has clearly specified whether recovery was to be premised on knowing or intentional conduct, negligence, or entirely innocent mistake. Petitioners fail to establish any showing of control or lack of due care, both ingredients for liability under §15 of the 1933 Act, making clear that the comment, even if erroneously applied to §15 is harmless. It is also clear that Judge Hoffman speaking for the Fourth Circuit was quoting directly from a footnote to this Court's opinion in Hochfelder which reads:

"28. Each of the provisions of the 1934 Act that expressly create civil liability, except those directed to specific classes of individuals such as directors, officers, or 10% beneficial holders of securities, see §16(b), 15 USC §78p(b) [15 USCS §78p(b)], Foremost-McKesson, Inc. v Proident Securities Co. 423 US 232, 46 L Ed 2d 464, 96 S Ct 508 (1976); Kern County Lane Do. v Occidental Petroleum Corp. 411 US 582, 36 L Ed 2d 503, 93 S Ct 1736 (1973), contains a state-of-mind condition requiring something more than negligence."

There is no doubt that he was speaking to the 1934 Act and thus the "scienter" requirement found to exist by this Court in Hochfelder.

CONCLUSION

Because there was no genuine issue of any material fact, entry of summary judgment in these cases was proper. The result was fair and accurate and came after a significant amount of discovery which brought forward for the lower Courts' review all of the pertinent events which occurred. Beyond cavil, Harris Upham established that it had no actual or other

form of control of its former employee after February of 1974. That the employee dealt with these Petitioners, some three, five and seven months later in the sale of unregistered securities does not impose liability on Harris Upham. Beyond the fact that Mr. Northcott at one time worked with Harris Upham, Petitioners have not produced a scintilla of evidence that in May, July and September of 1974 Harris Upham had even the remotest form of contact with them, in connection with their purchase of securities through Northcott.

There is no establishment of "control" because Harris Upham purportedly filed a defective RE-4 form with the New York Stock Exchange.

Imposition of liability upon a brokerage firm upon the facts of this case would permit the Federal Courts to be inundated with security litigation against "deep pocket" brokerage firms for the activities of its former employees, who could or might have gotten their "bad start" by working with a member New York Stock Exchange firm. Such is not the intent of the Congress with regard to the

1933 and 1934 Acts nor should such theory be given judicial support by this Court. Harris Upham is simply not liable to these Petitioners and the Writ of Certiorari should be denied.

Respectfully submitted,
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Counsel for Respondent,
Harris Upham & Co., Inc.

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APPENDIX A

Opinion of the Court of Appeals
for the Fourth Circuit

No. 77-2051

Thomas S. Carpenter and
Elliott Taylor,

Appellants,

v.

Harris, Upham & Company, Inc.,

Appellee.

No. 77-2052

Joseph Warren, III, Mark B. Edwards,
and Edwards & Warren, Professional
Association,

Appellants,

v.

Harris-Upham and Company,

Appellee.

No. 77-2181

Eldo Grogan, William Mills, and
Gene Patton,

Appellants,

v.

Harris, Upham & Company, Inc.,

Appellee.

No. 77-2182

Michael B. Allran, Edward R. Anderson,
A. J. Beall, Jr., Anne C. Hawley,
Barbara Morgan, Robert S. Morgan,
G. F. Parker, Samuel White,

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G. F. Parker, Samuel White,
R. W. Cannon, Dominic Capelli,
Pauline Capelli, Frank W. Cayce,
John Gaylor, Jr., John A. Jenks,
Frank Manship,

Appellants,

v.

Harris, Upham & Company, Inc.,

Appellee.

O R D E R

The panel as constituted in the above cases
has voted to deny the petitions for rehearing
filed by all appellants.

The full court has been advised of the peti-
tions for rehearing and no judge of the court has
indicated that the petitions be granted.

The petitions for rehearing are DENIED.

FOR THE COURT

/s/ Walter E. Hoffman

Senior United States District
Judge*

*Senior United States District Judge for the
Eastern District of Virginia, sitting by
designation.